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**The Cascade of Fear: Policy Implementation and Financial Management Reform in the  
European Commission.**

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## **The Cascade of Fear: Policy Implementation and Financial Management Reform in the European Commission.**

Abstract.

The complexity of managing European Union (EU) spending programmes is the subject of much comment but relatively little academic analysis. Using a multi-disciplinary analytical framework drawn from the management, policy and social sciences, this fieldwork-based case study examines the reform of financial management within the European Commission. In constructing an agent focussed narrative of a specific reform episode, it contributes to a growing literature on public management reform analysed from this perspective and also to the lightly developed field of EU financial management.

## Introduction.

With the exponential growth in the budget of the European Union (EU) since the late 1970s, the EU's executive arm (the European Commission, 'the Commission'), has had to adapt to the managerial consequences of its large spending programmes (Metcalf 1992, Cini 1996, Laffan 1997, Levy 2000, Stevens and Stevens 2001, Nugent (ed.) 2000). Since the advent of the Kinnock-Prodi reforms in 2000, there is now a considerable body of literature on the Commission's public management self-reform policies (Pollitt and Bouckaert, 2004, Levy, 2002, 2003, 2006, Bauer, 2006, Bauer ed. 2008, Levy and Stevens, 2004, Kassim, 2004, 2008), although relatively little of it focuses on financial management or treats the reforms as policy making processes in their own right (Barzelay and Jacobsen, 2009, Levy et al., 2011).

As urged over many years by the European Court of Auditors ('ECA' or 'the Court', the EU's external auditor), the European Parliament's Budgetary Control Committee (COCOBU), net contributor Member States (e.g. the UK, the Netherlands, Sweden), and external stakeholders such as the UK's House of Lords Select Committee on the European Communities, the Commission has progressively adopted the rhetoric of the '3 Es' and devoted ever more resources to audit activities (Laffan, 2003, Levy, 2000, Davies et al., 2008, House of Lords, 2007). Thus, by 2008 over 10% of the staff of the Directorate-General for Regional Policy (DG REGIO) was employed on these activities compared to less than 5% in 2000 (Méndez and Bachtler, 2011, p753). Our interview fieldwork here confirmed a doubling of audit staff in the Directorate-General for Employment, Social Affairs and Equal Opportunities (DG EMPL) over the same period. The apotheosis of this trend was the commitment by the first Barroso Commission in 2005 to the objective of achieving a completely 'clean' set of accounts (in the parlance, a positive Declaration of Assurance), by

2009. To this end, it adopted the Integrated Internal Control Framework (IICF) Action Plan in 2006, based as it was on the ECA's 2004 single audit model (ECA, 2004; European Commission 2006; Levy et al, 2011).

At one level, the Commission's acquisition of new management responsibilities can be explained by standard European integration theory as a 'spillover' effect of an expanding supranational policy role (Haas, 1968, Lindberg, 1963). At another level, it has been identified as part of the broader 'audit explosion' (Méndez and Bachtler, 2011), delineated in Power's work (Power 1997), or of New Public Management (NPM) reforms in the OECD generally (Pollitt and Bouckaert 2004, Levy, 2002, Kassim 2004, Ellinas and Suleiman, 2008). While neo-functionalist integration theory posits an apolitical technical teleology beneath human agency with a Weberian rationale for the resulting organisational form, NPM gives an alternative vision of the spread of 'private sector' forms, norms and values, through an almost 'social movement'-like international trend springing from concerns about government 'performance' and high levels of spending (Hood, 1991, Dunleavy and Hood, 1994).

These approaches offer some valuable general insights, but are not designed to bring a sufficiently fine grained understanding of the specific management forms developed and implemented for particular programmes, the sequencing of these reforms, or the social mechanisms underlying human agency in these processes. Thus, neo-functionalist predictions of centralised bureaucratic outcomes resulting from incremental policy change in the EU are contradicted, for example, by the simultaneous fragmentation and centralisation of management structures precipitated by the organisational crisis in the Commission in 1999 (Levy, 2006). Suggesting entirely different outcomes, the NPM framework has been

developed in the context of the adaptation of pre-existing large scale governmental organisations ‘reinventing’ and often ‘downsizing’ themselves (Pollitt and Bouckaert 2004). This is useful in understanding the rhetoric of Commission reform, but the latter has taken place in the context of a rapidly expanding portfolio rather than a stable or shrinking one.

### Case, theory and methods

The present study instead takes a different, more complex route, one largely neglected hitherto by scholars of EU management. It builds on a case study-based public management policy making literature (Barzelay 2003, Barzelay and Feuchtner 2003, Gaetani 2003, Barzelay and Jacobsen 2009, Corbett 2010, Barzelay and Gallego 2010, Levy et al., 2011), which combines a narrative research style (Ragin 1987, Becker 1997) enriched by ethnography (Berger and Luckman 1966, Goffman 1959, Weick 1993, Vaughan 2009), with event-centric, mechanism-based explanations from classical policy cycle analysis (Pressman and Wildavsky, 1973, Kingdon, 1984, Baumgartner and Jones, 1993) and organisation science (Cyert and March 1963, Allison 1971, Levitt and March 1988), and the analytical sociology of collective action (Smelser, 1962, Hedström and Swedberg 1998, McAdam, Tarrow and Tilly 2001, Abbott 2001, Hedstrom and Bearman 2009). The result of this combination is a dense organisation-focussed case narrative, structured around the policy cycle processes and human agency delineated respectively in the policy cycle and collective action literatures.

As this case focuses on shifts in the direction of policy within a discrete organisational setting, the Baumgartner and Jones (1993) partial equilibrium model of policy sub-systems is particularly useful. A sub-system is an institutional structure which is responsible for policy

making coupled with formal and informal arrangements in defined decision venues (Baumgartner and Jones, 1993, p7, Barzelay, 2001, p.59). When the potential for policy direction change is high, a disequilibrium situation occurs in the sub-system until partial equilibrium and an orderly flow of consistent decisions is restored. Within this event sequence, models of collective action become relevant to explain the motivations of key organisational players, hence the salience of ethnographic research among those groups.

The locus of our earlier research on the Commission's IICF using this frame (Levy et al., 2011), was primarily at high level policy choice. This case is situated further down the decision chain, specifically at the policy decisions involved in the implementation of financial management reform in the European Social Fund (ESF) by the Directorate-General for Employment, Social Affairs and Equal Opportunities (DG EMPL), between 2006 and 2009. In Baumgartner and Jones' terms, the case tracks the interaction of the ESF policy sub-system (including delivery agencies in the Member States), with the internal (the Commission IAS, auditors in the DGs) and external (the Court, the EP COCOBU) control sub-systems.

In brief, DG EMPL along with the Directorate-General for Regional Policy (DG REGIO) is responsible with the Member States for the management of the EU's Cohesion Funds, the collective term for economic development measures in disadvantaged regions and among disadvantaged groups in the labour market. These programmes are jointly funded with the Member States in varying proportions over 7year programming periods coinciding with the EU's financial framework, and are implemented on the ground by a variety of Member State agencies, typically local economic development bodies and specially created programme management teams. The aforementioned DGs have an essentially supervisory role, first

approving, and then monitoring and auditing the operational programmes in the Member States.

The empirical basis of the study is drawn from two sources. First, EU documentation including ECA annual reports and declarations of assurance (DASs), the Annual Activity Reports (AARs) of DG EMPL and Directorate-General for Regional Policy (DG REGIO), and annual reports from the Commission's Internal Audit Service (IAS) and Anti Fraud Office (OLAF)); and second, in-depth fieldwork interviews carried out in the autumn of 2008 with nine DG EMPL decision makers at Head of Unit level and above. The interviews ranged in length from one to two and a half hours, and were designed to elicit the reflections and judgments of those involved in implementing the reform. This achieved two goals: it enabled a more profound understanding of the policy processes and the statements found in the document review, and it created a snapshot of the organisational consciousness of the leadership of the DG. The latter is reported as the section on the dramaturgy in the DG and includes some illustrative quotations of the collective mindset.

The narrative starts with a description of the policy and actor context so as to inform the elite interview ethnography and the subsequent account of the policy responses. Using the Baumgartner and Jones analytical frame, the episode analyses the interaction between the Cohesion Policy, internal control and external control sub-governments, identifying the social mechanisms at work in the decision processes. Within this context, 'control' is used as a generic for the range of financial management controls, 'audit' refers to systems compliance audit, and 'external audit' presumes the practice of random sample transaction testing as used by the ECA in its annual reports and DAS.

## The *mis en scène*

In 2006, all Commission Directorates-General (DGs) had to begin implementing the IICF Action Plan in their areas of responsibility according to a strict timetable (European Commission, 2006). As joint partner with DG REGIO in the management of the EU's Cohesion Funds, it was the job of DG EMPL to reorganise its own financial management systems and to get the implementing agencies in the Member States to do the same to achieve compliance. Given the model of 'shared management' (Strasser, 1992, Marks, 1993, Bache, 1998, Levy, 2000) between the Commission and the Member States for these programmes, this was both particularly difficult (see below) and necessary, as high error rates above the upper threshold (a 5% level of materiality) adopted by the ECA for its transaction testing methodology, were perennially reported in its Annual Reports and DAS (Méndez and Bachtler, 2011, Davies et al, 2008, Levy et al, 2011).

In every ECA Annual Report in the period under review, the Commission responses give a standard explanation for poor financial management in the Cohesion Funds. From the ECA's Annual Report for financial year 2007 for example, it says the risk to payments are high 'because of the number of bodies involved in the implementation at different levels and the high number of beneficiaries and co-financed operations linked to the overall volume of funds' (Commission in ECA, 2008 p.145). This explanation is repeated more or less verbatim in successive AARs of DG EMPL (e.g. European Commission, 2008a p.17, 2010a p.23,). While accepting this general view, the Court focuses on compliance failures, deliberate or otherwise, which are classified as either eligibility, occurrence or accuracy errors, or multiple errors comprising a combination, or compliance errors which are 'mainly errors in public procurement procedures and failure to meet publicity requirements' (ECA, 2008, p.145). The

Commission's solution to these problems - that 'the first level of management verifications and the certification function are working properly' (Commission in ECA, 2008, p.145) – was essentially the implementation of the IICF, and the single audit model on which it is based as espoused by the ECA in its now famous Opinion 2/2004 (ECA, 2004). Simply, this argued for a system of internal audit in which each level of management from the most local up to each DGs' own internal audit capability (IAC), could rely on and accept the findings of every other level. This would obviate duplication, and provide a firm, efficient and reliable basis for external audit (i.e. audit by the Court itself).

The weaknesses highlighted by the Court in 2006 for the structural/cohesion funds for the financial year 2005 (ECA, 2006 pp.115-32, see below), coincided with other pressure factors. These included the implementation of the IICF action plan (European Commission, 2006, Levy et al., 2011), the enhanced audit requirements of the new financial regulation applicable to all EU spending, and the first year of the new accruals-based accounting system (ABAC). Specifically, there was budget preparation work for the EU's new financial framework (2007-13), and the concomitant introduction of the new cohesion/structural fund regulations (Council Regulation 1083/2006). Finally, there was the level of errors being found by the Court in its transaction testing of the funds for financial year 2006.

On the management of the funds, the Court found that the Commission did 'not maintain effective supervision to mitigate the risk' of controls delegated to the Member States failing to prevent ineligible expenditure; for the programming periods 1994-99 and 2000-06, 'expenditure was not free of material irregularities', with some programmes closed (i.e. signed off as completed), 'without a sound basis' (ECA, 2006 pp.12 and 128). Of the 95 current projects audited, 60 were affected by material errors, including lack of supporting

evidence for spending, disregard of procurement and state aid rules, declaration of unpaid advances, ineligible expenditure, misallocation of overheads (ECA, 2006, p.119). Worse was to come, because as the Court's report was being published in the autumn of 2006, its auditors were finding an error rate of 12% in the transactions it was testing in current structural fund projects (ECA, 2007a).

In addition to the Court, and *à propos* the IICF Action Plan, the IAS carried out a major exercise in 2006 'to determine whether the Commission ha(d) put in place a system to verify if the control systems presented by Member States meet the required standards, to assess the controls put in place at DG level, including assessment of cooperation with Member States and to evaluate ex-post controls carried out by the structural funds DGs' (European Commission, 2007, p.8). It made a series of recommendations requiring action by DGs EMPL and REGIO including establishing a common audit strategy, greater coordination with Member States 'including through contracts of confidence' (where the Commission would leave financial control to the Member State on the basis of assurances given to it regarding audit standards), and closer scrutiny of Member State levels of assurance, improved compliance with minimum auditing standards with results 'clearly disclosed in the DGs' annual activity reports'; and the speeding up of the financial correction procedure (European Commission 2007, p.8-9). Meanwhile, OLAF opened up 28 new investigations into alleged frauds on the structural funds, so that by the end of the year there were 46 cases open compared to 26 at the beginning (OLAF, 2007 p.31).

As noted, this was not all that DG EMPL had to deal with. The implementation ABAC was not going according to plan. In its report for 2006, the IAS noted that 'attaining complete compliance with all accounting standards throughout the Commission is a process which will

take time to complete. Migration of ABAC assets...and the inclusion of ABAC contracts in ABAC workflow are still at the preliminary studies stage' (European Commission, 2007 p.7). While applauding the Commission for modernising the system 'within the calendar and organisational framework imposed by the Financial Regulation', the Court reiterated its view that 'the timetable established for the necessary adaptations and validations was very ambitious' (ECA, 2006 p.16). It found that in many DGs 'weaknesses were identified concerning the validation of the data: weak supervision, lack of staff assigned to the task and inadequate documentation of the work done...(and) individual methodologies for Directorates-General were frequently not finalised/formalised by the different Authorising Officers before the presentation of the accounts' (ECA, 2006, p.19).

On the positive side, the Court opened its Annual Report by endorsing the IICF initiative and the January 2006 Action Plan (ECA, 2006 p.3), but of course delivery of that came at a considerable cost to the DGs, particularly EMPL and REGIO. It will be recalled that the IICF Roadmap contained specific provisions for the structural/cohesion funds (actions 13-15), echoing the weaknesses identified by the ECA and the Commission itself (European Commission, 2005, see also Levy et al. 2011, Méndez and Bachtler, 2011, and Davies et al 2008), and that the 16 actions in the IICF Action Plan had an implementation deadline for the end of 2007 (European Commission, 2006). While it was challenging enough to reform internal financial circuits in the DGs, it was infinitely more so to persuade agencies in 25 member states to change theirs in the same time frame; but this is what DGs REGIO and EMPL were obliged to do.

#### The dramaturgy in DG EMPL

As we have argued, an appreciation of the mindset of the decision makers in DG EMPL is fundamental in order to understand the reform episode (Collingwood, 1946, Berger and Luckman, 1966). During the period of the most intense change (2006-08), perceptions and responses were focussed at one level on specific events and institutions – the Court, the Parliament, the Member States, the error rate, the use of the payments interruptions system, the AAR. At another level, they expressed more general feelings of hope, resignation, fear, frustration, self- and organisational esteem, lack of control, isolation. To illustrate, we have interpolated this section with anonymised fieldwork interview quotations.

As noted earlier, along with DG REGIO and the Member State delivery agencies, DG EMPL interacted with actors and practices in the external and internal control sub-systems. These were perceived as often difficult relationships over which the DG had limited control. Respondents expressed feelings of being under incessant scrutiny by the EP and the ECA, and were not always confident that the Commission was giving the ‘best picture’ to the Court. The EP was seen as taking an increasing interest in controlling the budget, so putting an enormous political pressure on the Commission, in particular over the Cohesion Funds, the only spending area completely ‘red coded’ by the ECA since the introduction of the so-called traffic lights system in 2004/5:

*(If the ECA comes each year with a negative report saying no DAS then the EP discussion becomes very complicated because the EP needs to give the Commission a discharge saying it has managed the funds correctly, because the commission is in charge at the end for managing the funds. So year after year these have become very difficult discussion... Interviewee 6*

*We have been under constant scrutiny by the EP, ECA as to how this has worked out: Did the Commission give the best picture to the ECA, Could the ECA understand, were they handled appropriately, are all the things auditors would look for there, are they correcting errors, is*

*money paid out incorrectly being reversed? This has since been a major point politically and in the media.....every year since the ECA has come with the most damning reports.... Interviewee 2*

*Politically it would never come to a satisfying conclusion.....Both the ECA and the Commission are competing before the European parliament.... Interviewee 3*

There was a mix of feelings about why this was the case: some saw it as evidence of relatively poor management of the Cohesion Funds compared to other programmes, others took the view that the ECA was exacting a price for being ignored, a situation which could be rectified through building better relationships between the DG and the Court. Such optimism was balanced however, by the view that the Court was inflexible, and working to a different set of standards and methodologies:

*Last year was very traumatic. The ECA claimed 12% of Structural Funds should not have been paid out because the underlying transactions were riddled with errors.....All funds were criticised but particularly the Structural Funds.....This has led to a very detailed discussion between us and the ECA as to the methodology in reaching that figure, particularly because the 12% is only based on a sample, so how serious were the errors across the projects....., we have now come to the conclusion that there was no point continuing the debate about methodology..... Interviewee 6*

*DG EMPL didn't cultivate appropriate relations with the ECA. The negative report by the ECA was motivated because they felt neglected. As result, for the last 12 years the ECA report a negative DAS....Interviewee 3.*

*The ECA started to see things we had not reported..... The ECA also feels we are not severe enough with Member States.....Interviewee 4*

*The ECA and the EP only look at a tiny proportion of overall projects – so we will not discover everything.... which leads us into a big debate then about 'Control'. If we are not*

*able to say it is 2% but somewhere between 2% and 12% you are in deep political water. Our conclusion – there was no point continuing the methodological debate.....Interviewee 6*

This perception was symptomatic of more general feelings of alienation and lack of control. The policy making environment was seen as highly contingent, where decisions took up to 2 or 3 years to finalise with actors holding out until the last minute before reaching agreement. Despite the best efforts of officials, optimal ‘rational’ solutions (as they were seen) were bested by those which were politically acceptable to the Member States:

*We make the legislative proposals two to three years in advance, and no matter how much effort we put in, and indeed in fairness no matter how much effort the member states put in, you will not get an agreement on that legislation until the night before the money runs out. And you will not get.... an agreement on the legislation until after they've agreed what the next budget is. And of course they won't agree the next budget until the night before the money here runs out, which means you don't get an agreement on the legislation until the night before the money runs out. And that's just the dynamic.... Interviewee 1*

The accommodation of the Member States through consensus building measures was routinely alluded to. But consensus, while desirable was not the only *modus operandi*, and as DG EMPL came under pressure to improve its performance, increasingly less possible. For example, the voluntary system of Member States entering into so-called ‘Contracts of Confidence’ with the Commission had not really worked:

*I think two or three member states might have kind of operated it in an informal sense but it never really developed from that. And that was why in the legislation we had to bring in ... the compliance assessment for example now which.... we've introduced now in substitute of that... Interviewee 1*

Underlining this shift in outlook, the big stick of payment interruptions came to be used far more aggressively over the period (see below). The intention was already there insofar as the new regulation (Council Regulation 1083/2006) embodied this way of thinking. The weapon had been designed, manufactured and was ready for use. Its honing through a new IT tool (the A-REP system, see later), reinforces the argument that there really had been a change in mentality:

*We don't control the member states. We can only pressurise. But now with pressure from parliament we are between two fires. Hence, the big gap in the number of suspensions this year. It is the only way of maintaining a credible story....Interviewee 7*

*We HAVE to make sure the money is getting spent VERY close to people so the system has to be highly regionalised and highly localised. We can take many measures to simplify – lump sum funding etc – but several member states say that it isn't possible in their country....*

*We HAVE to assume that errors will occur and that responsibility for control is ours.*

*So, every year we will have a political fire.....Interviewee 6*

The increasing use of the stick was underpinned by the view that the pursuit of consensus had not produced the desired results anyway (because of half-hearted implementation at the Member State level), and feelings that the DG's efforts were often misunderstood and that it took an unfair share of the blame for control failures. Thus the 'benefit of the doubt' had shifted from the Member States as the DG toughened its position, much as the ECA (and the IAS) had recommended it do, 'cleaning up' as it went along rather than waiting until sometimes years later in the cycle. The adequacy of Member States' reporting standards and obligations were mostly given short shrift, adding to the climate of low trust. Withholding funds to get the desired improvements and shifting the audit burden onto the Member States (see below), were both vindicating and liberating from the DG's point of view:

*We get an annual declaration from the Member States of an audit assessment – it is not at the political level....But the declarations we have received have very little content... the regulations don't allow us to ask for more. Essentially, the national assessments are not worth the paper they are written on.....Interviewee 9*

*We've asked member states to introduce action plans to correct the errors, and in some cases we have required corrections. And of course corrections can be done in two ways, they can be done by the member state itself, or we have procedures in hand now where we are going through the legal procedures to impose corrections..... "You have to improve". And while we keep saying that they don't get paid.....Interviewee 1*

*It comes back to member states very directly. I mean in a very practical way. If I take this year, we had I think it was eight member states in reserve (i.e. under review – RL), with 65 operational programmes, and for those 65 operational programmes (of 117) we had stopped payments, pending the establishment and implementation of an action plan for correction by the member states. We had something like 22 operational programmes in Spain blocked. And that means we're not making any payments..... Interviewee 8*

Irrespective of these perceptions, the actions taken (see below) were arguably only an extension and an application of the thinking behind the IICF/single audit model, based as it was on a hierarchy of compliance with sanctions if necessary. Given the high political priority which had been given by the Commission in 2005 to the achievement of a positive DAS, and the adoption of the IICF Roadmap and the Action Plan with their ambitious timetables as the chosen means, the responses in DG EMPL were understandable:

*So the choice is clear – we tighten up on the Member States. And we have drawn up an Action Plan saying as much. We have a much stronger position on suspensions. We have doubled the number of auditors. We have a much stricter rule on the recovery of money..... we will be able to say – we are very tough now – we aim to recover money within 6 months or 24 months – new key figures. Previously, files would stay on the director-general's desk for years... Interviewee 1*

## The measures

Officials in DG EMPL had to create, find and use means to fulfil the ends set by others, and not at a pace of their own choosing. This meant (a) some internal re-organisation and redeployment of resources, (b) the creation of new tools and structures, and (c) the deployment of hard and soft powers in a more vigorous configuration. In every aspect of the change process, it was pressed hard to act.

We turn first to the new legislative centrepiece encapsulating its rights and obligations, Council regulation 1083/2006. While placing a raft of new compliance obligations on the member states (Méndez and Bachtler, 2011), it also required DG EMPL and DG REGIO to police member states, both *ex ante* through the prescription of the form and content of compliance control systems in each operational programme (OP), and *ex post* through the scrutiny of annual written assurance reports at 3 levels of control (i.e. from managing authorities, audit authorities and national authorities). If the Commission was not satisfied at any stage of the ‘dialogue’ with a Member State agency, then after due notification, payment interruption or suspension could be invoked.

The power to suspend payments already existed, but interruption was new. In its annual report for 2006, the IAS said that DG EMPL’s and REGIO’s performance was not good enough in this regard, stating ‘that the financial correction procedure for the cohesion fund should be significantly improved to reduce its overall length’ (European Commission, 2007 p.9). This has to be taken in the context of another damning judgment from the Court on the management of the cohesion funds in 2006 (ECA 2007 pp. 43, 48, 148-50), the immediate

commitment by Siim Kallas, the Commissioner for Administrative Affairs, Audit and Anti-Fraud and Commission Vice President, to take ‘further actions’ including moving ‘more rapidly toward formal suspension of interim payments’ (Kallas, 2007 p.2), and the resulting specific action plan for the funds in February 2008 (European Commission, 2008c). Thus, DG EMPL’s adoption of ‘new procedures for formally suspending ESF payments..... aim(ed) at reducing delays for suspending payments in order to better protect the EU budget.... on the basis of ECA and national audit reports’ (European Commission, 2009 p.43), in April 2008 was the culmination of a deluge of bad news, not a pre-emptive strike.

Leaving aside the timing of this change, it nevertheless had significant effects on performance (see later) and organisation. On one level, the ‘new procedures’ represented a change in attitude in the DG as we have argued. To put that into practice required the creation of an audit report database (the A-REP system), and a supporting organisational structure to action the outputs from the database. The A-REP database contains the audit findings and recommendations of the ECA and of DG EMPL auditors on member state OPs, and links these directly to Member State action plans, payment interruptions, suspensions and financial corrections. For each audit finding or control recommendation, all follow-up actions undertaken by DG EMPL (from initial letters up to ultimate financial corrections) are registered in the A-REP system. Once recorded, a negative audit report would automatically come to the attention of the Geographical unit (Geodesk) responsible for the OP. The standard procedure was for the relevant Geodesk (there are 8 grouped on a multi country basis), to inform the management authority in the Member State of the audit findings, setting the stage for discussions that would normally lead, first, to agreement on an action plan and, then, to an assessment of the action plan’s implementation.

*We've had to build a new database system to allow us to track.... And it's what we call our A-REP system. As soon as we get an audit report that's red, it goes into the system. It's flagged, goes to the Geodesk, they write to the member state, and then from that you're in a system whereby the computer tracks progress and we have automatic emails that go to the Head of Units every three weeks, reminder ones. And we have reports every two weeks to senior management on the progress of it....Interviewee 1.*

It also strengthened the role of the recently created Directorate for Audit and Controls in DG EMPL, copied from DG REGIO practice (Méndez and Bachtler, 2011 p.752), 'encouraged' by the IAS, and an iteration of the 'internal audit capability' (IAC) ushered in by the Kinnock-Prodi reforms. In establishing this Directorate, the programme evaluation function was transferred to a newly created staff office reporting directly to the apex of DG EMPL so separating programme evaluation organisationally from the audit services in order to prepare for the increase in audit staff. As a result, the number of audits performed by DG EMPL surged to 113 in 2008 (86% of OP's ESF expenditure), compared to 68 in 2004 (European Commission, 2009, p.34).

Key to the operation of a more aggressive interruptions regime was the *de facto* empowerment of the Heads of the Geodesks in the audit and payment interruption/suspension processes. Before 2007, the ESF audit unit sent its audit opinion directly to the Director-General level, but since then it has gone to the Heads of the Geodesks. Responsibility for providing assurances in the form of management opinions now rests with them, and their signatures appear in the same way that the Director-General's signature appears on the AAR. This allocation of responsibility is congruent with signature authority for disbursement of funds to member states, a result of their role as authorizing officers by sub-delegation. In effect, they have the responsibility and authority for both approving and interrupting payments. Likewise, they play important roles in actions to suspend payments or impose

financial corrections. At the same time, information related to Member State controls was made available to them, and requests for clarification sent to Member States as necessary. Based on these inputs and any others available (from sources such as national audit institutions, ECA, OLAF, European Court of Justice), they built up management opinions for each OP. The enforcement mechanism is a quarterly report prepared individually by all the Heads of the Geodesks, on the degree of adherence to the COSO-based internal control standards operating across all DGs since 2000 (the system was fine-tuned later in 2008 to make it exclusively exceptions-based):

*One of the difficulties we identified is that Auditors and Geo Desks don't work well together systematically and there was no way of knowing where this was happening and where it was not. System was merely formalising what was in the procedures – helped/forced people to comply with procedures... Interviewee 2*

*We have gone through a radical re-alignment of our management structures here. It is correct to have a management structure.... whereby you have your operational units within geographical directorates. And it's correct to have your auditor separate because that's their function, to be separate. But then of course you're confronted with the organisational challenge of ensuring communication and co-operation.....Interviewee 1*

Not satisfied with the effects of the IICF action plan on the management of the structural funds, the EP asked and the Commission promised (Kallas, 2007), in late 2007 to launch a specific initiative as a condition for granting the discharge for financial year 2006. The Commission adopted an Action Plan for strengthening its supervisory role of the structural funds on 19 February 2008, very much reflecting the recommendations set out by the ECA in its 2006 Annual Report and its Opinion 6/2007 (on the annual summaries and national declarations of Member States and audit work on EU funds of national audit bodies), and the suggestions made by the EP during the discharge procedure. The plan comprised 37 actions

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compared to the 16 in the IICF Action Plan. The key elements related to programme closure for the 2000-2006 programming period (closure deadlines are very generous – article 89 of regulation 1083/2006 governing the 2007-13 programming period sets a final deadline of 31<sup>st</sup> March 2017 for the submission of documents to the Commission by the Member States for final payments), completion of all IICF actions, the issuing and dissemination of guidelines to managing and certifying authorities on certification, eligibility, audit sharing, statistical sampling, fraud indicators, annual summaries and Annual Control Reports for the new programming period. Most importantly, the measures envisaged a fine-tuning of those in place since 2006 seeking to step up audits of high risk OPs (i.e. those where irregularities have already occurred, audit and control arrangements are deemed to be weak, or utilisation rates (i.e. take-up) are low), to ensure more rapid follow-up on the results of audits, and to proceed more quickly to suspension of payments and recoveries.

As in the case of the IICF Action Plan, the cohesion/structural funds Action Plan specified outputs and indicators, together with deadlines so that its implementation could be monitored, in this instance by the EP on a quarterly basis. The final implementation date was set at 31st December 2008, with certain actions ongoing (European Commission, 2008c). The Commission provided a final report to the EP on 31st January 2009 (i.e. in time for informing the discharge procedure for the financial year 2007), which showed that by the end of 2008, the Commission had largely delivered on the outputs set out (7 actions were pending, and these were fully implemented in 2009 (European Commission, 2011a p.4)).

The final element of the implementation episode was the result of another IAS initiative, namely the reform of the AAR process. This ranked as the first item in the IAS report for 2007, where AARs were described as ‘a key component of the Commission's governance

architecture'. But the design and purpose of the AAR was to be significantly altered, signalling a shift away from a policy goals focus and towards a financial management goals focus. The reports would now include 'more explicit guidance on how the different components feed the assurance, including an explanation of how the IAC opinion has contributed to the assurance; a precise definition of the control strategy; systematic and mandatory use of key indicators on the functioning of control systems; reconciliation with findings by the European Court of Auditors (ECA) and explanations of delays in the implementation of critical and very important internal audit recommendations' (European Commission, 2008b p.7). To dispel any lingering complacency, 'a more extensive peer review' was planned for later. In the context of the refocusing, the response in DG EMPL was to designate the internal control coordinator (the link person in each DG with the IAS, effectively a two way communication channel), as also the AAR coordinator.

#### The results – what and for whom?

Within the EU institutions, there is a consensus that financial management improved between 2006 and 2009, although interpretations vary about the degree of improvement. The EP, Court and the IAS are more reserved in their judgments than DG EMPL, and competing and conflicting data do not help clarification. But generally, the EU actors are consistent in heaping blame for control failures on the Member States, which don't get a right of reply. However, some redress is afforded through the research carried out in 2009/10 which shows that the new regime has been entirely negative from the Member State point of view for three reasons: first, the imposition of onerous and costly compliance requirements; second, the delays to project funding caused by compliance; and finally, the more aggressive imposition of payment suspensions and the use of payment interruptions (Méndez and Bachtler, 2011

p.756). It is harder both to get money and to keep it flowing. Thus, the ECA reported 'that for the policy group Cohesion only 20 % of the amounts confirmed in 2009 (2 411 million euro) have been implemented (476 million euro) in the same year. Added to the amounts outstanding from previous years, a total amount of 2 332 million euro still remains to be implemented at year-end 2009. Unless further expenditure declarations are submitted by Member States in subsequent years, the remainder will be implemented only at the closure of the programmes' (ECA, 2010 p.30). Simply put, many actions scheduled for implementation at the start of programmes would take place much later, and be paid for only at programme termination.

In terms of payment interruption activity by DG EMPL, the Commission reported in 2011 that '72 interruptions of payment deadlines and 15 Commission suspension decisions were adopted for ESF Operational Programmes' between 1 January 2008 and 30 June 2011, and that on 1 July 2011, 'there were 38 decisions of interruption of payment or financial correction proceedings ongoing (17 interruption decisions, 14 pre-suspension letters, five suspension decisions, two pre-correction letters)' (European Commission, 2011a, p.23). For DG REGIO, there are figures for 2010 when there had been interruptions to 49 programmes amounting to EUR 2.15 billion, and by 1 July 2011, 'payments to 76 operational programmes were stopped (including payments for 40 programmes interrupted, 34 preventive, warning letters sent to programmes' authorities to prevent them from sending any payment request as long as the identified weaknesses were not corrected and 2 programmes without an approved compliance assessment)'. (European Commission, 2011a, p.23). This suggests that whilst DG REGIO had latterly adopted an aggressive interruptions policy, it had been slower than DG EMPL in doing so.

Praise from the IAS can best be described as lukewarm. After examining controls by DGs REGIO and EMPL over the management and control systems the member states had announced for the 2007-13 programming period '(t)he IAS shares the ECA's view that it is too early in the programming period to conclude that the changes to the rules and supervisory systems have succeeded in reducing the number of errors in payments at final beneficiary level' (European Commission, 2010b p.8). It found that 'although the checks were performed as intended, the process suffered from delays incurred by the Member States' services'; there were 'concerns about the quality of the information provided at Member State level and (it is) recommended that the DGs follow these up in the next stage of the assurance building process'. DGs needed to 'define their own audit strategies more explicitly, in particular the extent to which they take account of the results of Member State audit work'; there was room 'for a more coordinated audit approach between the Commission and Member States, or even for joint audits, particularly when different audits concern the same national audit authorities' (European Commission, 2010b p.8).

The ECA annual report for financial year 2009 showed that 36% of the 180 audited Cohesion fund payments were affected by errors, though this was an improvement on 2008 and 2007 where the corresponding figures had been 43% and 54%, respectively (ECA, 2010 p.101). Looking at it another way, DG EMPL estimated that out of all the ESF programmes, 27% were providing 'reasonable assurance' (31% for 2007), while 61% were providing 'reasonable assurance with moderate impact' of identified weaknesses on EU payments (26% for 2007). A further 9% of the programmes were classified as providing only 'limited assurance with significant impact' of identified weaknesses on EU payments (29% for 2007) and 3% provided 'no assurance' (14% for 2007) (European Commission, 2010a, p. 43).

These numbers showed a trend towards the increase of programmes with reasonable assurance and only moderate impact of deficiencies.

The ECA has reported an estimated single error rate for cohesion policy as a whole for each financial year since 2007. This stood at more than 5% of cohesion expenditure certified by Member States in financial year 2009, and 7.7% in financial year 2010 when the average rate across all programmes was 3.7% (ECA, 2011 Table 1.2 p.18). While substantially above the 2% materiality threshold the Court generally uses (this figure based on the international standard adopted by COSO in 1992), they were less than the 11% figures for 2007 and 2008. Based on calculations made by DG EMPL, the Commission has claimed that the share of ESF projects in cohesion policy errors reported by the Court fell dramatically in that same period: in 2006 and 2007 errors in ESF projects contributed by 38% and 44% respectively to the cumulative quantifiable errors for cohesion policy, but in 2008 and 2009 these percentages had dropped to 2% and 7% respectively (the share of ESF expenditure within cohesion policy as a whole remained around 20% over the period) (European Commission, 2011a p.11).

This claim should be treated with extreme caution however, as it cannot be even approximately replicated using the transaction testing data published by the Court for any of those years. Indeed, in explaining the new approach upon which these figures were based (essentially drawn from total disbursements rather than on a numbers-of-programmes-affected basis), DG EMPL itself cautioned that '(t)his rate of error is therefore not comparable and should not be compared to any error rate presented by the European Court of Auditors in their 2010 annual report' (European Commission 2011b, p.45). Additional work was needed, it said, 'in order to check the methodology used by the national Audit

Authorities and to provide guidance where necessary, in order to improve the consistency of the methods used and to reach increasingly reliable error rates' (European Commission, 2011b, p.45). The achievement of the single audit model presaged by ECA Opinion 2/2004 and the IICF project, let alone a positive DAS, was still some way off it seemed.

### Summary, explanations and conclusions

The main events in the implementation episode occurred in the primary context of heavy top down and external pressure on DG EMPL to achieve an acceptable ECA-defined error rate, and to implement the IICF and the accruals-based accounting reforms. The legislative centrepiece of the remedial action - Title 6 of Council regulation 1083/2006 which gave DGs EMPL and REGIO new powers to interrupt payments and placed new compliance obligations on Member State implementing agencies under the supervision of DGs EMPL and REGIO – had a gestation period of 2-3 years before enactment. In order to implement these provisions, DG EMPL developed tools and practices which included automation of the payment interruption trigger via the creation of the A-REP database, the imposition of a more intensive 3 layered quarterly reporting regime on the Member State agencies, the devolution of interruption decision functionalities to the Heads of the Geodesks, and the upgrading of the IAC. An action plan and a new format for the AARs were additionally imposed from the outside, and the DG also sought later in the episode to redefine the error rate to show its performance in the best possible light.

In terms of the Baumgartner and Jones model, the partial equilibrium pertaining in the structural fund policy sub-system had, under the pressures outlined, transitioned to disequilibrium so allowing a resetting of the policy agenda as the financial management

‘domain structure’ underwent redefinition (Barzelay, 2001, pp.61-2). From the evidence gathered, the dramaturgy is suggestive of a group of actors which perceived themselves to be misunderstood and virtually friendless, and felt under intense pressure to raise performance. Conditions of threat had prevailed (McAdam, Tarrow and Tilly, 2001) in the DG for a number of years, producing a social construction of reality (Berger and Luckman, 1966) within which the mainsprings for action were defined. While this climate of fear and threat was a primary driver for decision makers, the choices made must also be understood in the context of the perceived available solutions. These had to be congruent with the dominant rule-based bureaucratic norms of the Commission and the by now well-established folklore in the EU’s institutional community that the Member States were culpable for most of the error (ECA, 2007b).

From the standpoint of the threat felt within the DG, this was attributed to a number of recurring sources: the ECA’s annual DAS, specifically the error rate, the annual discharge drawn up by the COCOBU, some members of the College of Commissioners in particular Commissioner Kallas, and the Commission’s own internal services in the form of the IAS and OLAF. Given the subordinate position of DG EMPL within this institutional landscape, the DG had to find a strategy to neutralise the threat without aggravating relationships with those actors, and which drew on the accepted beliefs and ‘rules of the game’ we have just outlined (Cyert and March, 1963). This explains the preference for the regulatory approach in general, and the specific targeting of the Member States’ compliance obligations and systems, plus the addition of the new ‘stick’ of payment interruption to beat them with. From a bureaucratic point of view, the ‘automation’ of the new sanctions regime via the A-REP system was a highly desirable culturally compliant outcome, as it vitiated any potential claims that particular programmes were being arbitrarily targeted by Geodesk officers. In

essence however, the effect of the policy shift was to transfer the threat from DG EMPL to the Member State implementing agencies.

At the micro level, the empowerment of middle managers fitted in with the new management paradigm ushered in by the Kinnock-Prodi reforms (Kassim, 2008). The upgrading of the internal audit capability to full Directorate status, the rise in the level of audit activity and the imposition of more stringent audit reporting, was simply an iteration of the IICF locally, a project pushed and prodded forward by the gatekeeper of the faith, the IAS, itself originating from the ECA's single audit opinion 2/2004. As with other aspects of this public management reform process, these actions were congruent with the consensus across the EU's institutional boundaries. The redefinition of the error rate can be seen as part of a longer term Commission project to get the ECA to report lower rates however, and is thus still an area of contention in this landscape.

Finally, this case study has more general significance as it further enriches the case narrative public management reform literature, in particular showing its salience to more routine, lower level elements of policy making. In the specific area of management reform in the EU institutions, it adds another case to those few using the policy cycle approach, an approach that hitherto has been largely confined to the analysis of EU 'high politics'. It also makes a new contribution to the neglected field of EU financial management reform, a dark continent for academic research for far too long. It is hoped that this case will inspire others to shed more critical and analytical light in this area.

ENDS

## List of acronyms

AAR – Annual Activity Report

ABAC – Accruals Based Accounting System

A-REP – Audit report database

COCOBU – Budgetary Control Committee of the European Parliament

DAS – Declaration of Assurance

DG EMPL - Directorate-General for Employment, Social Affairs and Equal Opportunities

DG REGIO - Directorate-General for Regional Policy

ECA – European Court of Auditors

ESF – European Social Fund

EU – European Union

IAC – Internal audit capability

IAS- Internal Audit Service

IICF –Integrated Internal Control Framework

OLAF- Anti-Fraud Office

OP- Operational Programme

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